

REAL ESTATE
AS EXEMPT



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PALO ALTO REAL ESTATE BOARD)

For Appellant: Bruce G. Fielding
Certified Public Accountant

Stephen G. Hill
Associate

For Respondent: F. Edward Caine
Senior Counsel

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O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Palo Alto Real Estate Board against proposed assessments of additional franchise tax in the amounts of \$25.00, \$25.00, \$362.57, \$216.49, \$244.60 and \$264.44 for the taxable years 1958 through 1963, respectively, based on income for the years 1958 through 1962,

The question presented is whether, for the years in question, appellant should be classified as an exempt corporation.

In 1948 appellant was incorporated as a nonprofit corporation. It continued the purposes, policies, and activities of its unincorporated predecessor, which had been a member of the California Real Estate Association since 1915. Appellant's articles of incorporation provide that it was formed to

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... unite and promote the general welfare of those engaged in . . . the real-estate business; ... foster and maintain well-established standards of conduct in the . . . real-estate business; ... uphold ... all codes, rules and regulations promulgated by or under the authority of the United States Government for the regulation of the real-estate business; and ... to promote the general welfare of the community.

Since its creation, appellant's activities have included: publicizing a code of ethics; hearing complaints on alleged unethical practices; assisting the civil defense authority; sponsoring a "Get out the Vote" campaign; endorsing and actively working for hospital, school, and other bond issues; distributing League of Women Voters' handbooks; appointing liaison committees to attend city council and chamber of commerce meetings; sponsoring high school essay contests; awarding plaques for civic work; meeting with federal housing officials to discuss housing problems; assisting Ford Foundation officials in overcoming housing problems; publicizing veterans' exemption information; sponsoring real estate educational conferences and other educational courses; providing instructors for real estate courses; publishing talks by educators; and sponsoring little league teams.

Appellant's members are in three categories: (1) Broker Members, who are persons, firms or corporations with broker's licenses, regularly engaged in the real estate business; (2) Associates, a class composed of others in the real estate business, such as salesmen of a broker member; and (3) Affiliates, consisting of other persons and entities interested in appellant's aims, such as financial institutions.

In 1952 there were 43 **broker** members and 30 associate members. In 1954 there were 42 broker members and 21 associate members. Thereafter, membership steadily **grew**, there being 85 broker members and 204 associate members in 1963.

Appellant had one full-time employee in 1952. In the fall of 1962 an additional employee was hired.

In 1952 appellant began operation of a multiple listing service, a service open only to broker members. Membership in the listing **service** was optional with them. A \$1,000 fee was required for membership. During the years in question approximately 80 percent of appellant's broker members were

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multiple listing service members. Of broker members joining appellant since 1958, 7 of 29 chose not to join the listing service.

Pursuant to the multiple listing service's rules and regulations, listing service members elect a governing committee. Changes in the service's rules and regulations must be ratified by appellant's board of directors. The service and appellant have a common treasurer and appellant exercises control over disbursements.

The service afford all of its members the opportunity to sell property which is placed on a multiple listing. Exclusive listings of designated property acquired by the listing broker become exclusive listings of the service. Appellant's Listing service division receives as a fee on multiple listing sales 3 percent of the sales commission. In the usual instance the balance is divided two-thirds to the selling broker and one-third to the listing broker.

The listing service is intended to result in profit to appellant so it may accumulate funds to acquire a site and build or purchase a building of its own. Appellant needs additional space for classrooms and conference rooms in connection with its activities.

Appellant's total gross income for the years in question increased from approximately \$21,000 in 1958 to \$42,000 in 1962, while its total expenses increased from approximately \$21,000 to \$37,000. The percentages of gross income and expenses attributable to the multiple listing service for each of the years were as follows:

	<u>1958</u>	1959	<u>1960</u>	<u>1961</u>	<u>1962</u>
Gross income	51%	51%	65%	66%	52%
Expenses	51%	47%	55%	43%	47%

For each of the years under consideration, appellant's expenditures related to activities other than the multiple listing service far exceeded appellant's increases in earned surplus.

As of December 31, 1962, appellant's earned surplus was less than \$29,500. All but \$1,560 thereof was in cash. Part of the cash was in a checking account and the rest was in savings accounts being accumulated for land and building acquisition and construction.

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It is respondent's position that the operation of the multiple listing service deprived appellant of its exempt status.

Under the statutes which are relevant to the question before us, business leagues, chambers of commerce, real estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any individual are exempt from the franchise tax except for the tax on "unrelated business net income." (Rev. & Tax. Code, §§ 23701, 23701e, 23732.)

Respondent's regulations provide that:

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.... A stock exchange is not a business league . . . and is not exempt from tax." (Cal. Admin. Code, tit. 18, reg. 23701e.)

The above provisions are substantially the same as those found in the federal code and regulations. (Int. Rev. Code of 1954, § 501(c)(6); Treas. Reg. § 1.501(c)(6)-1.)

Although the above quoted language of the regulation refers only to business leagues it applies to real estate boards as well. (Evanston-North Shore Board of Realtors v. United States, 320 F.2d 375, 377 [footnote], cert. denied, 376 U.S. 931 [11 L. Ed.2d 650].) In the cited case, a multiple listing service substantially similar to appellant's was held to operate primarily for the benefit of individual realtors rather than for the benefit of the real estate business generally. The court recognized that the interests of the real estate business generally and the interests of the public were benefited by the service because a broader and more active market. for real estate

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resulted under controlled ethical conditions. Nevertheless, the court concluded that the most immediate benefit was to the individual participating realtors.

The court reached its conclusion for a number of reasons that apply also to the case before us. The court pointed out that the fees charged for the listing service were in approximate proportion to the benefits received by each realtor. The court also stated that the listing service was a "sales tool" at the disposal of the individual realtors and that there was a compelling analogy between the operation of a multiple listing service and a stock or commodity exchange.

The court recognized that if the principal purpose and activity of a real estate board is such as to justify exemption it does not lose its exempt status by engaging in an incidental activity which, standing alone, would be subject to taxation. The court held, however, that the multiple listing service activity was more than incidental: and exemption was denied. In that case it was estimated that about 61 percent of the board's gross income was derived from its multiple listing service activity and that more than half of its expenses were attributable to that activity. The court found that an increase in personnel, from one employee to five full-time employees and one part-time employee, was due, in large measure, to the operation of the multiple listing service.

The court commented:

We do not say that financial data of the type here present is the only relevant criterion of the importance of one of an organization's many activities. But we do hold that the relative contribution to plaintiff's receipts and expenditures of its listing service, and the amount of personnel which the service requires are sufficiently substantial that the listing service cannot be regarded as an incidental activity of the Board.

The facts relevant to the question of whether appellant's multiple listing service is an incidental activity are substantially the same as those in the Evanston-North Shore

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case. The majority of appellant's gross income is derived from its listing service and approximately half of appellant's expenses go toward maintaining the service. Although appellant had but one employee during most of the period in question, it may reasonably be inferred that much of his time was devoted to the Listing service. The minor differences that exist between appellant's case and the Evanston-North Shore case do not justify different results. As in the Evanston-North Shore case, appellant's multiple listing service was more than an incidental activity.

We conclude that on the particular facts of this case and for the particular years in question, appellant is not entitled to be classed as an exempt corporation.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Palo Alto Real Estate Board against proposed assessments of additional franchise tax in the amounts of \$25.00, \$25.00, \$362.57, \$216.49, \$244.60 and \$264.44 for the taxable years 1958 through 1963, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of May, 1966, by the State Board of Equalization.

_____, Chairman
John W. Lynch, Member
Paul R. Lee, Member
Philip A. Hearn, Member
_____, Member

ATTEST:

[Signature], Secretary